Russia's economic transition: the outcome and the prospects ; sustained growth possible, but with caveats

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Inhalt

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Rußlands Wirtschaftstransformation – Ergebnisse und Aussichten

Anhaltendes Wachstum ist unter Vorbehalten möglich

Bericht des BIOst Nr. 16/2000

Kurzfassung

Vorbemerkung

Die Transformationskrise in Rußland war schmerzhafter als die Große Depression in den USA, weil schwere Schocks die Komponenten der gesamtwirtschaftlichen Nachfrage in den 90er Jahren massiv beeinträchtigten. Doch neueste Daten belegen eine deutliche Wirtschaftserholung und führen zu Irritationen, da verschiedene Erklärungshypothesen aufgestellt werden können. Eine geht von einem vorübergehenden Produktionswachstum aus, das durch ein temporäres Zusammenspiel günstiger makroökonomischer Faktoren bewirkt werde. Ein anderes Erklärungsmuster beruht auf der Überzeugung, bei der derzeitigen Stabilisierung handle es sich um eine Dauererscheinung die aus verbesserten Fundamentaldaten herrühre. Ein wachsendes Vertrauen in die Fähigkeit der Regierung die Wirtschaft zu lenken nähre den Optimismus von Investoren und Verbrauchern, und treibe die Produktion voran. Es ist dennoch nicht einfach, sich für die eine oder andere Hypothese zu entscheiden, da die Fakten beide zugleich erhärten können.

Ergebnisse

1. Der Rückgang der Investitionsnachfrage, die den Wirtschaftszyklus primär bestimmt, macht deutlich warum der Produktionsrückgang so massiv war. 1992 leitete man marktwirtschaftliche Reformen ein, aber die Investitionsrate begann zu sinken und erst 1999 scheint der Rückgang gestoppt worden zu sein. Die Investitionsnachfrage reagiert gewöhnlich auf den Zinssatz, was bedeutet, daß die Zinspolitik die Investitionen attraktiv machen muß. Das gelingt nicht immer – bei unzureichender Zinselastizität der Inverstitionsnachfrage werden Investitionen selbst bei niedrigen Zinssätzen manchmal unterlassen. Insbesondere in den frühen 90er Jahren waren die realen Zinssätze in Rußland deutlich unter Null – ausgerechnet in der Phase des gravierendsten Investitionsrückgangs. In einem solchen Fall sind die Möglichkeiten der Geldpolitik – wie das russische Beispiel belegt – begrenzt.
2. Doch auch die Finanzpolitik scheiterte: Über mehrere Jahre gab das Budget mehr aus als es einnahm, aber die Investoren verglichen die alternativen abgezinsten Renditen und mieden das Investieren in den realen Sektor. Banken, Investmentfunds und Privatpersonen zogen es dagegen vor, aus den hohen Zinsen der Regierungsanleihen

Nutzen zu ziehen. Interessanterweise scheint die viel kritisierte hohe Unternehmensbesteuerung etwaige Investitionsentscheidungen weniger zu entmutigen; was mehr stört in Rußland ist die willkürliche Besteuerung und das unzuverlässige Steuerrecht.

3. Der Produktionsrückgang und die allgmeine Steuerhinterziehung hatten massive Ausgabenkürzungen und eine Rückführung der Staatsquote zur Folge. Das zog eine Reduzierung der Gesamtnachfrage und dadurch der Wirtschaftsleistung nach sich. Beispielsweise bewirkt eine Kürzung des Staatsverbrauchs um einen Rubel ceteris paribus einen Produktionsrückgang von bis zu drei Rubel. Andererseits konnten die Transferzahlungen der Behörden den Ausgabenrückgang teilweise ausgleichen, da die Transfers zwischen 1992 und 1998 real um 45% zugenommen haben. Sie haben die Reaktion der aggregierten Nachfrage auf die Kürzung des Staatsverbrauchs abgeschwächt, so daß der kombinierte Effekt ein Rückgang der Wirtschaftsleistung um ca. 39% in 8 Jahren gewesen sein dürfte.

4. Der Privatverbrauch verringerte sich real weniger als die Wirtschaftsleistung. Weil er aber den Löwenanteil an der Gesamtnachfrage aufweist, zieht sein Rückgang unweigerlich eine Produktionskürzung nach sich. Auch die Umverteilung des Volkseinkommens zugunsten der "neuen Reichen" hatte keinen positiven Effekt auf die aggregierte Nachfrage, d.h. die viel beachtete Geldverschwendung der Systemwechselgewinner hat die Wirtschaft nicht ankurbeln können. Weil die Einkommensschwankungen und die allgemeine Unsicherheit in Rußland relativ lange, etwa 10 Jahre, anhielten, dürfte es einiger Zeit dauern (es sei denn ein furioses Wachstum setzt ein) um das Vertrauen der Verbraucher wiederherzustellen und das Wirtschaftswachstum zu beschleunigen. Eher wird ein zögerliches Anpassen des Konsums an das Einkommen auch eine langsame Reaktion der Produktion auf die Ausgabenerweiterung bewirken; erst wenn die Einkommensverbesserung als dauerhaft perzipiert worden ist, kann ein schnelles Wachstum zustande kommen.

5. Im Unterschied zu den anderen Komponenten der aggregierten Nachfrage halfen die Ausfuhren die Krise abzumildern oder schneller zu überwinden. Die überdurchschnittliche Bedeutung des Exportsektors ergibt sich z.Zt. aus dem beachtlichen Exportmultiplikator. Zugleich weist Rußland prozentual zum Inlandsprodukt recht hohe Leistungsbilanzüberschüsse auf, was auf entgangene Investitionschancen hinweist, da ein Teil der inländischen Ersparnis im Ausland angelegt wird. Eine die ausländischen Direktinvestitionen fördernde Privatisierungspolitik wäre dazu geiegnet, das Wachstum zu beschleunigen und die Nettoexporte zugunsten einer größeren inländischen Investitionsrate zu reduzieren.

6. Nachfrageseitig geprägte Schritte der Zentralbank führten zu einem Rückgang der Monetisierung der Wirtschaft. Das weist auf lediglich beschränkte Möglichkeiten des Bankensystems hin, die Geldmenge via Bereitstellung von inländischem Kredit zu erweitern. Die Sparer scheinen nur ungern ihr Geld den Banken anzuvertrauen, da die realen Einlagezinsen entweder gering oder negativ sind. Die Zinselastizität der Nachfrage

nach Bankeinlagen ist gegenwartig kleiner Eins, d.h. das Publikum erachtet die Einlagen als inferiore Güter von nachlassender Bedeutung. Ein geringes Bargeld-Einlagen-Verhältnis verringert die Geldmenge und hindert die Investitionen. Die Banken bieten niedrige Einlagezinsen wegen hoher Refinanzierungskosten, die durch die Zinspolitik der Zentralbank verursacht werden. Noch bis 1998 gaben sie diese Kosten an die Kunden weiter, indem sie auch hohe Kreditzinsen verlangten, die die Wirtschaft lähmten.

7. Etwas unerwartet begann die Wirtschaft 1999 zu wachsen. Das ist entweder eine Folge exogener Faktoren (Mitnahmeeffekte der steigenden Rohstoffpreise und der Rubelabwertung), oder zyklischer Erholung. Während die exogenen Faktoren als vorübergehend zu betrachten sind, könnten die zyklischen Effekte von anhaltender Bedeutung sein. Bei näherer Analyse der Komponenten der Gesamtnachfrage kommen jedoch Zweifel auf, ob der verbesserte Zustand der Wirtschaft auch wirklich von Dauer ist. Die Untersuchung der Investitionsnachfrage deutet nicht darauf hin, daß die Unternehmen mit besseren Wirtschaftsaussichten rechnen und den Kapitalstock zu erweitern beabsichtigen. Der private Konsum hat sich auch nicht erholt und kann demnach das Wirtschaftswachstum kaum ankurbeln.

8. Unter diesen Bedingungen erlangen die Ausgaben des Staates und die Exporte entscheidende Bedeutung. Beide stiegen an und scheinen die Gesamtnachfrage aufrecht erhalten zu haben. Für den Fall daß sich die temporären exogenen Faktoren abschwächen, werden die Staatsausgenen – ceteris paribus – wegen der klaren Budgetbeschränkung sinken müssen. Das könnte zusammen mit einer möglichen Verschlechterung des Export-Import-Preisverhältnisses (terms of trade) und einem starken Rubel die Wachstumsaussichten unterminieren.

9. Auch die Entwicklung des Geldangebots kann nicht ein herannahendes stetiges Wachstum belegen. Ein expandierendes Geldangebot spiegelt normalerweise das Vertrauen der Anleger wieder, woraufhin Ersparnisse dem Bankensystem zugeführt und der Wirtschaft oder den Haushalten ausgeliehen werden. Die langsame und unzulängliche Wiederherstellung des Bargeld-Einlagen-Verhältnisses steht für eine anhaltend niedrige Sparquote der privaten Haushalte, aber auch für Mißtrauen in das Bankensystem angesichts der verheerenden Erfahrung der Sparer in den 90ern, und der weiterhin negativen Habenzinsen. Mehr noch, die Zentralbank versorgte kürzlich die Banken mit Liquidität, die sie nicht ausleihen können. Die hohen Überschußreserven und die damit verbundenen höheren Pflichtreserven stützen die Kreditrationierung via kleineren Geldmultiplikator und trüben die Wachstumsaussichten. Während in der Vergangenheit eine lockere Geldpolitik lediglich Inflation auslöste, vermag sie auch gegenwärtig nicht die Wirtschaft zu beschleunigen.

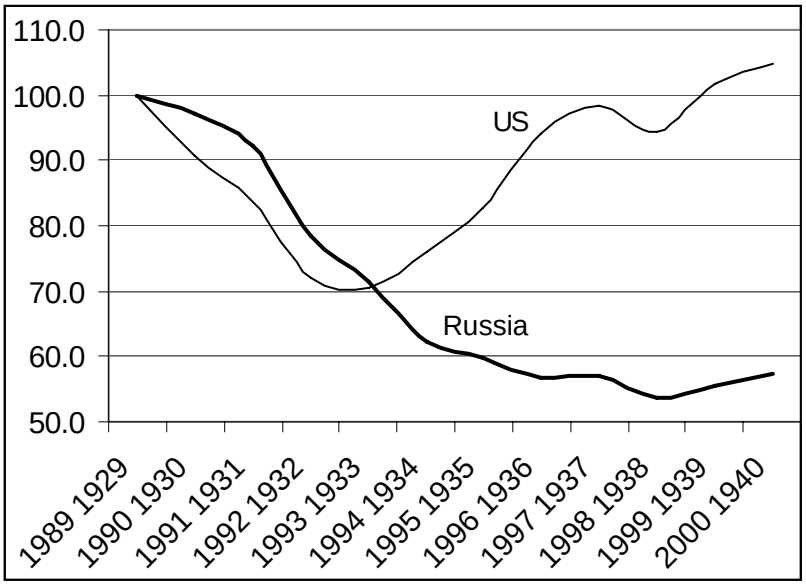
10. Es ist folglich nicht einfach einzuschätzen, ob das gegenwärtige Wachstum von Dauer ist oder nicht. Da die exogenen Faktoren als unsicher zu betrachten sind, müssen die zyklischen Faktoren – insbesondere das Vertrauen der Investoren und Konsumenten – zulegen. Andernfalls dürfte sich die derzeitige Wirtschaftsbelebung bald erschöpft haben.

1. The macroeconomic results after ten years of transition

When thinking of the transitional depression in Russia, one might seek similar events to compare it with, and might recall the Great Depression. The Great Depression hit the US economy harder than any other crisis in its whole history. Triggered in 1929, the fall in output reached 30 percent within the next four years. Ten years in a row – between 1931 and 1941 – the average unemployment rate stayed at almost 19 percent, and the capital stock eroded and decreased because net investment was negative during the early 1930s. The stock market contracted to merely 20 percent of its pre-crisis value, and simultaneously the money stock shrank, too, causing an unprecedented deflation – by 1940 the price level was about 20 percent lower than in 1929. The most striking development, however, was the rapid growth in output as of 1934, which by the end of the 1930s had made up the initial losses (though neither unemployment nor the stock market recovered to the same extent).

The crisis in Russia developed quite differently: growth in output did not resume earlier than ten years after the crisis became obvious, and current real growth seems to be insufficient to restore the pre-crisis GDP soon (Diagram 1).

Diagram 1: Output index in Russia 1989-2000 and the US 1929-1940



2000 estimated. Sources: Government of the Russian Federation, Russian Economic Trends, Southampton, various issues Table 1; US Department of Commerce, The National Income and Product Accounts, various issues.

While in the US prices crumbled in response to the Fed's[1] tough monetary policy, inflation in Russia skyrocketed, melting away the savings of the population and causing a massive ruble devaluation index of roughly 50 thousand between 1991 and 1999. The composition of the

[1] The Federal Reserve System (Fed) is the US Central Bank with its Washington, D.C., based Board of Governors.

Russian gross domestic product (hereafter GDP) by sectors and regions also changed dramatically – the predominance of heavy industry was replaced by an expanding service sector, whereas subsidized mining and raw material processing regions suddenly lost their economic base, as budget transfers had to be cut. Although on paper the unemployment rate is still not high by international standards, a large portion of the labor force is idle.

The shocking balance of the transitional recession raises the question as to the reasons, although Russia is no exception: a whole range of post-communist economies (Ukraine, Lithuania, Bulgaria) experienced a similar, or deeper, slump in their output and even some Asian emerging markets collapsed massively in the aftermath of the 1997 financial crisis. But Russia differs in a way from other – either small or large, but less industrialized – nations such as the Baltic republics or Indonesia. The difference arises from the macro-economic facts: a large domestic market, well-skilled labor force, abundant natural resources, and last but not least significant expenditure relief stemming from a lower defense burden on the new, democratizing, country. As the former Soviet Union broke up, many observers believed that Russia would achieve a fast transition from a command to a market-based economy. Theoretically, more complex and less open economies are able to rely more strongly on their own resources, avoiding the adjustment distress that smaller nations face when forced to open up to the world market. The per-capita income level in Russia, admittedly, may have been lower than in the advanced economies, yet it would have been higher than the income actually turned out to be.

One of the first steps the new reformist government of prime minister Gaydar undertook in 1992 was, however, to abolish the state monopoly on trade and to change exchange rate policy towards a market-determined value of the ruble.[2] In terms of its trade in goods, Russia became an open economy, and an opening up in terms of capital flows followed closely. This provoked a long list of mismatches – low, centrally set domestic prices suddenly compared with higher world-market prices; low-quality domestic commodities had to compete with high-quality imported goods; the market-set exchange rate differed many times from the exchange rate at purchasing power parity; and so forth. Why did the Russians make these mistakes, instead of trying a gradual adjustment before exposing the economy to such external shocks? The answer is, they had to wrestle with several severe domestic shocks, too: the disintegration of the former Soviet Union crippled demand-side policies, as it left the State Bank (Gosbank, the USSR central bank) helpless in the face of the autonomous money supply practices of the republics, who spontaneously started demanding soviet ruble credits[3] on behalf of their budgets and thus decentralizing the overall money supply. Central Bank of Russia credits to the Commonwealth of Independent States went on until 1994, when they were finally discontinued. On the supply side, a worn-out industrial capital stock and a logistic mess failed to match the requirements of the consumers, entailing supply shortages;

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2 Nevertheless, a multiple exchange rate existed until 1993.

3 Anders Åslund: Why Has Russia's Economic Transformation Been So Arduous? Annual World Bank Conference on Development Economics, Washington, D.C., April 28-30, 1999, p. 5, in: www.worldbank.org/research.

tax collection, and thus payment flow, collapsed, and increasingly provoked industrial standstill, etc. In short: a mix of demand and supply-side shocks occurred, and economic policy was confused as to how to handle them.

The most convincing answer to the question of how to respond might have been to ignore the pressure for system conversion and to continue producing the old way with some gradual opening. Some see China's reforms since Deng Xiaoping urged the Chinese to get rich as confirming such a proposition. But with the benefit of hindsight we now know this was not possible, bearing in mind the differences in the starting conditions between the two countries. While China in the late 1970s and the Soviet Union in the mid-1980s realized the need for reforms, central decision-making was still more or less functioning in China. Not so in the USSR: perhaps due to Gorbatchev's reform attempts, a tendency to abandon the old system prevailed within society, weakening the decision-making power of the central authorities. The ensuing disintegration of the Union provoked a disruption of the technological links and financial flows, as the union republics and regions increasingly refused to "export" (except in return for hard currency), thus cutting off supply from demand and boosting the overall disarray. Another strong incentive for changes resulted from the shift in influence: a redistribution of power was under way, disadvantaging hitherto privileged groups such as the military, the Soviet-style "nomenklatura", and so forth, while strengthening other groups linked directly to the economy. The most startling examples are the infamous oligarchs and the red managers of the state-owned companies, but new private entrepreneurs made their fortunes, too, by drawing benefit from the general uncertainty prevailing at that time.

2. Aggregate demand by components

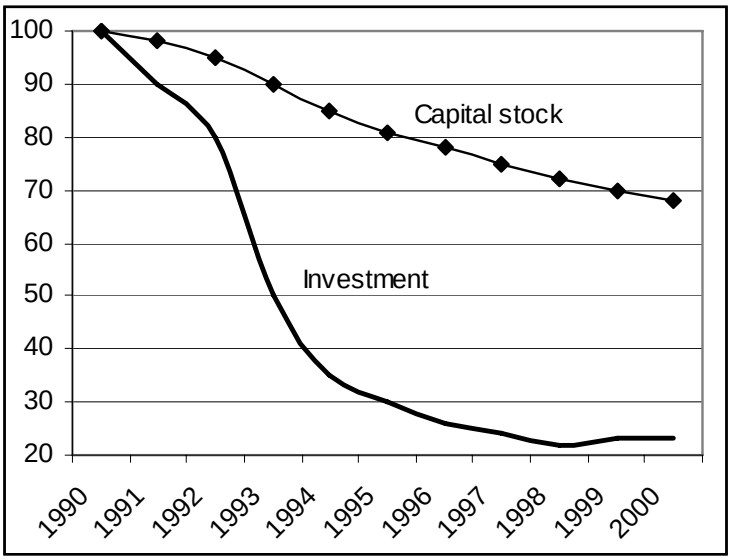
The so-called "young reformers" faced huge demand-side distortions that they had to handle quickly. To outline the challenge, a review of the components of aggregate demand helps to determine those which contributed most to the decline in output. As fluctuation of investment demand accounts strongly for the business cycle, the analysis will start with investment. The next demand component reviewed will be government spending, because theory suggests that, during a crisis, more purchases and transfers usually manage to revitalize the economy. The analysis goes on with private consumption. Consumption decisions reflect the past experience of the households and therefore depend on the consumers' sentiment. Finally, exports, which are considered as an exogenous demand component, will be analyzed. Notwithstanding this, exports often prove decisive in overcoming a recession, especially when the export/output ratio is high.

2.1 Investment demand

Since the Stalinist-launched industrialization, the Russians have always relied on a high investment rate to achieve real growth. Typically, they mobilized resources by keeping private consumption down, while strictly restricting capital outflows. On average, the former Soviet Union sustained an investment rate of some 24 percent of GDP, which enabled output growth at rates between 8 and 2 percent in the USSR's dawn years, and in the 1980s,

respectively. The decline in the growth rates is explained by the fall of the total factor productivity (TFP) during the last decades, that is to say, technical progress (modernization) has been contributing less and less to output expansion. In spite of the overall productivity loss, the capital stock appears to have always been quite modern in some sectors such as defense or space, where costs hardly mattered. Simultaneously, other (civilian) sectors suffered from an aging capital stock and lack of efficiency. The ebbing productivity gains are seen as an important contribution to the demise of the planned economy, as society became more and more frustrated with the disappointing results of the economic endeavors the communists demanded. Anyway, the public discussion on perestroyka stressed the need for a radical system change to catch up with the level of the West, which meant a change in property rights and, consequently, freedom to allocate capital more efficiently. Disappointingly, though the transition reform really got started in 1992, the fixed investment rate began to fall and the capital stock declined while deteriorating in quality (Diagram 2).

Diagram 2: Investment and capital stock index, 1990 = 100



2000 estimate. Source: Institute of macroeconomic forecasting: Ekonomika Rossii v nastupayustim desetiletii, Russian Academy of Sciences, Moscow, 1999, p. 10, 20.

The investment spending decline seems to have bottomed out in 1999, strengthening hopes of recovery. Because of the very low level in real terms – only about 20 percent of the amount spent in 1990 – the investment rate can be calculated at about 8 percent of GDP at this moment – clearly a poor result by international standards.[4]

When they plan to increase output, firms want to invest to raise the capital they have on hand. Investment demand usually responds to interest rates, and because it is negatively correlated

[4] Calculated assuming a 20 percent investment rate in 1990. In 1999 the investment index was 20 percent and the GDP index 50 percent, respectively, which means an investment level of 40 percent of the 1990 level (20/0.5). 40 percent of the 20 percent investment rate yields 8 percent actual investment rate.

to a higher interest burden, the latter discourages investors. In such a situation the monetary authorities are expected to lower the interest rates to make investment attractive. The result depends, however, on the sensitiveness of investment demand to the interest rates – sometimes high rates might not lead to a large decrease and, what is even more important, low rates may not always strongly encourage investors. Pessimistic business sentiment may make investors reluctant to expand fixed capital and may thus harm growth prospects. In the early 1990s, especially, real interest rates, the indicator which de facto is important to investors, were clearly below zero in Russia – just in the phase of the most precipitous decline in investment spending. Under such circumstances, the opportunities open to monetary policy – as the Russian experience proves – are limited.

If monetary policy does not produce any definite encouraging effects on the investors' decisions, overall fiscal policy becomes crucial. While in the short run more government spending may increase aggregate demand and help output to recover, increasing deficit spending provokes growing budget imbalances. In the early 1990s, the deficits were large, yet had no positive effect on GDP growth. Instead, an adverse result occurred: deficit financing by borrowing usually moved up interest rates and crowded out private investment in fixed capital. This became increasingly unattractive, as investors compared the expected discounted returns of other, alternative, investment opportunities – in real-economy projects or in government bonds and exchange rate speculations – and mostly avoided putting money into factories. Instead, banks, investment funds and private persons rushed to take advantage of the high interest rates offered by government bonds. In 1996, the real returns from such investment still reached an attractive 60 percent per year – a really unthinkable yield for a "normal" firm producing goods in a competitive market.

The portfolio investment rationale eroded the propensity to invest in the capital stock in two ways: firstly, foreign capital and know-how stayed away from Russia's industrial sector, as they were crowded out by the demand for funding the Federal Government in Moscow. Secondly, the new private owners of the former Soviet assets quickly figured out that any efforts to modernize, restructure, and produce would not be suitably rewarded, as higher returns could be obtained by converting tangible assets into financial assets.

The result was disastrous: obviously, the investment decline is linked mainly to the decision of the new owners of the business assets to disinvest, which cut aggregate demand and provoked an economic depression. Moreover, it left firms short of fixed capital. Disinvestment started within a highly uncertain environment, when the big state-owned companies faced increasing difficulties in producing and selling. Thus, by accruing a growing debt (liabilities) the net value of such companies diminished. For clever entrepreneurs it was cheaper to register a private trade company, buying the low-priced output of the industry dinosaurs and selling it at market prices. The reverse was practised too: selling inputs at high prices and buying final goods for pennies. The owners of the new companies were either the red directors of the state enterprises or their relatives or business partners, which helped to eliminate competition and price setting according to market rules. The same persons resisted a legal move towards fast privatization and thus accelerated the asset-stripping of the soviet-

style economy. Investment in fixed capital was not worthwhile, because firms remained state property. On the other hand, the new companies were low-capital trade-sector firms and therefore promised high profits at less risk. Ideologically, the postponed privatization and opening of the stock exchange for foreigners were defended as a social and patriotic step to prevent Russia's sell-off to rich foreigners.

Meanwhile some Russian businessmen have became very rich, too, and are able to interfere with the policies of the Federal Government. In an infamous insider debt-for-equity swap in 1995, money tycoons obtained stakes in key industrial enterprises, which were paid for with inflated private bank credits to the budget. Neither experienced in running those industries (mostly oil extraction and non-ferrous metallurgy), nor willing to attract management know-how and advanced technology from the West, they even accelerated the companies' demise by siphoning out money and transferring it overseas. When this became obvious, the values of these companies fell sharply below the already low purchasing prices. For instance, Norilsk Nickel, the large non-ferrous-metal company is now worth one third as much as Oneximbank paid for it in a non-competitive deal in late 1995.[5]

Fluctuations in investment spending reflect the expectations of the firms, which feel persuaded to invest only if they anticipate a long-term sustained output growth. Production expansion entails a respective expansion of the capital stock, but with a time lag and "overshooting". The latter implies that, while positive GDP growth induces accelerating investment spending, net investment will be negative when the economy is in a recession.[6] Thus, poor prospects for the economy cause a steady decline in investment and, consequently, a decay in the capital stock overall. Exactly that happened in Russia: while the GDP index was about 50 percent, the investment index fell even farther (Diagrams 1 and 2). The channel for depressing the output has therefore been, ceteris paribus, the sharp decline in investment demand.

Much has been said about the arbitrary taxation and the high income (corporate) tax rates in Russia. A high tax rate reduces the planned profit, but it allows firms to deduct a larger portion of the rental costs of capital (interest money paid on investment credit) from the tax sum they owe the budget. Businesses take advantage of the so-called tax credit to match their net returns[7] with the after-tax capital costs: a corporate tax rate of, say, 50 percent halves a planned profit of 10 percent. Since the rental cost was initially 10 percent too,[8] the firm is allowed to lower it by the tax rate of 50 percent and thus to maintain the microeconomic equilibrium. Consequently, it seems that the corporate tax rate tends to discourage investment decisions to a lesser extent; what is a cause of much more complaint in Russia is the arbitrary taxation and the uncertain tax legislation which businesses face.

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5 Anders Åslund: Why Has Russia's Economic Transformation Been So Arduous? op. cit., p. 20.

6 The accelerator model of investment asserts that the rate of investment will be proportional to the rate of GDP growth (positive or negative).

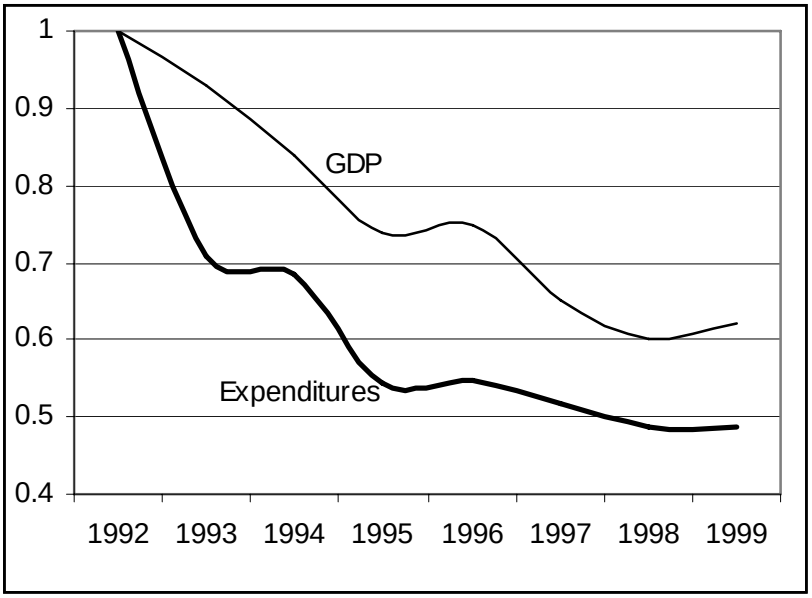
7 Correctly, they equalize the marginal product of capital with its rental cost.

8 To be in equilibrium from a microeconomic viewpoint, the marginal investment returns (say, 10 percent) must equal the investment price (likewise 10 percent).

2.2 Government spending

The transformation to a market-based economy enforced a radical reduction in the size of the Russian government as of the early 1990s. While state expenditures constituted about two thirds of GDP in 1992, they decreased to roughly one third in the mid-1990s and remain at this level today (Diagram 3). Such a massive cut in government spending was prompted by shrinking tax revenues, which in turn were the result of output depression and also of wide-spread tax evasion. A reduced-size government affects aggregate demand and causes output to fall. In a recovery phase, an increase in government spending stimulates a higher output growth than would be the case in an economy without government. In a recession phase, any reduction in government spending entails higher GDP losses, and budgetary policies targeting a balanced budget should be avoided unless strong growth is being attained.

Diagram 3: Index of real GDP and General Government expenditures



Source: Government of the Russian Federation, Russian Economic Trends, op. cit., various issues, Table 1, 11; Institute of macroeconomic forecasting: Ekonomika Rossii …, op. cit. p. 11-15.

Unfortunately, exactly this happened in Russia between 1992 and 1998, and there is strong evidence that the output slump was caused to a large degree by the budget adjustment. The decrease in government spending unleashes a greater GDP decrease because of the multiplier.[9] This is the amount by which production changes when (autonomous) demand

[9] To calculate the multiplier, suppose the aggregate demand AD is equal to the output (income) Y, i.e.: AD = C + I + G = Y; C = C + cYd; Y = C + cYd + I + G = A + c(Y - T), where C, I, G, and A denote autonomous consumption, investment, government spending and autonomous demand, respectively, Yd is the disposable (after-tax) income, T the tax revenues and c the marginal propensity to consume out of the disposable income. A = C + I + G. Since T are a portion of Y, T = tY, where t is the tax rate. Inserting into the equation of the income and removing the brackets yields: Y = A + cY - ctY = A + cY(1 - t). Hence Y - cY(1 - t) = A; Y(1 - c(1 - t)) = A; Y = (1/1 - c(1 + t))A = aA; Then DY = aDA, where a denotes the multiplier. If only government spending changes, DY = aDG.

changes by one unit, and since the multiplier is larger than unity it affects the economy even in the case of small demand changes. In Russia a vicious circle of government spending cuts and contraction of the tax base provoked a rapid output decline in the early 1990s. During the initial recession, the reduction in the size of government was accompanied by a substantial reduction in effective income taxation, which in a pure mathematical sense means a larger multiplier and more pronounced output decrease. Fortunately, lower taxation partly makes up for the malign impact of the spending cuts, since it encourages consumption spending. The need to reduce government spending in 1992/93 to a sustainable size appears, however, to have been unavoidable and thus a temporary recession (depression) seems to have been inevitable. Later – after 1993 – the Treasury failed to stabilize revenues, which obviously accelerated GDP decline and tax evasion, continuing the vicious circle. Moreover, the authorities lost their ability to revitalize the economy by increasing government spending. One ruble in additional demand created by the government would have caused output growth well in excess of one ruble, since in Russia's economy with low taxation the multiplier is large. Unfortunately, when spending cuts outpace the decline in GDP, the stabilizer's influence becomes negative, helping to turn the recession into a depression.

Demand-side policies concerning government spending are linked, firstly, to government purchases of goods and services, and secondly, to government transfers, including transfers of interest rate gains on government bonds. An increase in government purchases raises aggregate demand, and firms try to respond by increasing output. Because of the high relative weight of government purchases on overall spending, the effect of each additional ruble spent by the government is strong.

The share of government purchases in nominal GDP declined in Russia along with the size reduction in government during the 1990s, whereas the share of the transfers increased (Table 1).

Table 1: General Government purchases and transfers, ruble bn

Year	GDP	purchases	purchases/GDP (per cent)	transfers	transfers/GDP (per cent)
1992	19.2	9.2	47.9	1.9	9.9
1993	171.5	56.0	32.7	18.7	10.9
1994	611	204.4	33.5	70.8	11.6
1995	1540.5	415.2	27.0	195.1	12.7
1996	2145.7	567.9	26.5	330.6	15.4
1997	2586.4	718.3	27.8	398.4	15.4
1998	2684	664.9	24.8	400.6	14.9

Source: Russian Federation: Recent Economic Development, in: IMF Staff Country Report No. 99/100, Washington, D.C., September 1999, Tables 19, 20, 21.

In real terms (in 1992 rubles), government purchases contracted by 35, 12, and 51 per cent in 1993, 1995, and 1998 respectively. In 1994, 1996 and 1997 they increased by 16, 12, and 14 per cent, respectively.[10] These increases were, however, too weak to offset the decline during the rest of the decade, so the total shrink was 56.4 per cent. It is clear that such a deep cut in government purchases, which in turn constitute the largest portion of overall government spending (Table 1), has had a massive negative impact on output. As already suggested, the link between GDP contraction and the changes in government purchases is the multiplier. This depends on the (marginal) propensity to consume out of disposable income on the one hand, and the income tax rate on the other (footnote 9). Because of the severe economic crisis and the general decline in the income of the population, one can assume a fairly high (marginal) propensity to consume out of disposable income, which is the mirror picture of a declining saving rate. Simultaneously, personal income tax rates can be estimated to be low – either because individual income is low or for "technical" reasons such as corruption and tax evasion. It is well known that in the 1990s the Treasury's revenues relied mainly on sales taxes (value added and turnover taxes, and excises), whereas the authorities were unable to collect properly the planned direct, i.e. income, taxes. For instance, a marginal propensity to consume of approximately 80 per cent and an average income tax rate of roughly 18 per cent yield in mathematical terms a multiplier of 2.9. Depending on the actual taxation, the multiplier may be estimated to be at least between 2 and 3.[11] Put another way, one ruble less in government purchases causes, ceteris paribus, a decline of up to three rubles in nominal output.

While the reduction in aggregate demand induced by the decrease in government spending on goods and services has a strong malign impact on the equilibrium output, the increase in government transfers referred to earlier may have mitigated the overall strain on GDP. Higher transfer payments reflect a hitherto unknown phenomenon in Russian reality, linked to the new social commitment of the government, which is called upon to finance the health and pension systems and to provide benefits to individuals with low income. The transfer amount in Russia consists of the expenditures of the social security system, the social security payments made by the regional and local authorities, and the interest on the government debt. As a portion of GDP, it has increased since 1992 (Table 1). Transfers caused aggregate demand to respond less strongly to the cuts in government purchases of goods and services. The explanation is that transfer payments lower the sum spent by government itself and thus the multiplier.[12] Benefits help to keep demand higher despite unemployment and stabilize the output. If there were no transfers, aggregate demand in Russia would be even lower, and the cuts in government spending would have aggravated the crisis further. Therefore, the transfer

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[10] Computed on the basis of Table 1 taking into account the respective inflation rates, here the CPI.

[11] In the real word it might, however, be lower because, according to the IS-LM model, it actually depends also on the interest rates, which are low in times of crisis. Low rates encourage the economy and offset the slump to a given degree.

[12] An increase in transfers by one ruble lowers the government multiplier by that increase times the marginal propensity to consume, i.e. the multiplier changes to ca, where c and a are the marginal propensity to consume and the government multiplier, respectively.

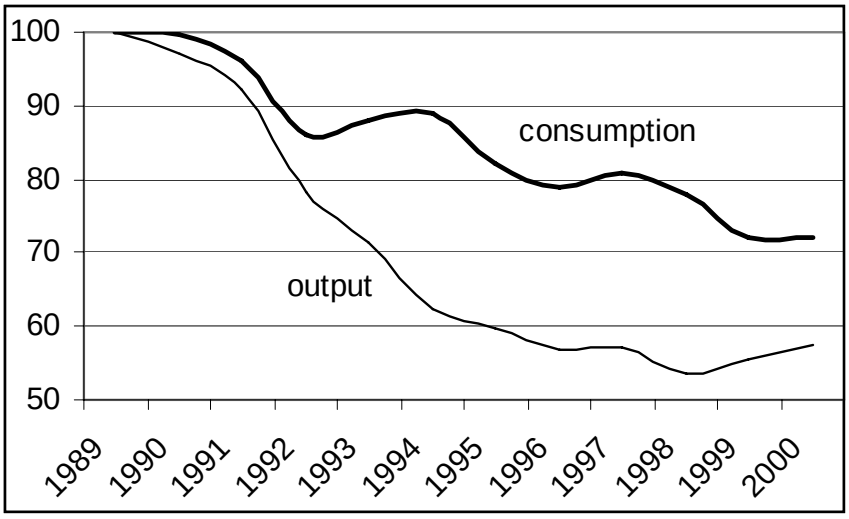
payments made by the authorities have partly outweighed the decline in expenditure. In real terms (1992 rubles), total transfer payments increased by almost 45 per cent between 1992 and 1998.

A substantial part of the total transfer payments is accounted for, however, by interest paid on the growing government domestic and external debt. Bearing in mind that, in the late 1990s, almost 50 per cent of interest payments went to foreigners, the overall impact of government transfers on the economy should be considered less important. Consequently, the combined effect – less purchases and more transfers taken together – of the change in the size of government was a severe output decline. Other things being equal, the combined effect of decreased purchases and increased transfers might have led to an overall fall in the real GDP by roughly 39 percent within 8 years.[13]

2.3 Consumption spending

Consumption spending in Russia stabilized at about two thirds of GDP, and thus accounted for most of aggregate demand. During the transitional depression it declined less in real terms than did the GDP, because individuals tried to maintain a smooth flow of consumption. They had planned their purchases with respect to their lifetime disposable or permanent income, and so consumption has not depended on current output only. In the short run, however, increasing liquidity constraints forced the Russians to reduce their actual consumption, as many did not have any savings left to draw down, high inflation having devalued them in the early years of transition (Diagram 4).

Diagram 4: Real household consumption and real output index, 1989 = 100



[13] Since the output change DY is a function of the weighted cuts in purchases DP and weighted transfer increase DT times the marginal propensity to consume c, both of them times the multiplier a, DY = 0.35*(-0.56) *2.9+0.8*0.1*0.45*2.9 = -0.387 or -39%. In real terms DP = -0.56, and DT = 0.45, whereas a = 2.9 when c is estimated at 0.8. Purchases and transfers are weighted by 0.35Y and 0.1Y, respectively Source: Russian Federation: Recent Economic Development, in: IMF Staff Country Report No. 99/100, Washington, D.C., September 1999 Tables 19, 20, 21.

Sources: Government of the Russian Federation, Russian Economic Trends, op. cit., various issues, Table 1.

A glance at the GDP breakdown by use makes it clear that the increase in the consumption/output ratio was possible only at the expense of the decrease in the investment/output ratio and the size of government, whereas net exports have expanded relative to GDP. But for output to increase, consumption must first rise, which would – because their levels are linked to income – help expand investment and government spending too, and so forth.

As the consumption curve in Diagram 4 indicates, consumption decline fluctuated in the 1990s. This might be a result of temporary increases in the disposable household income, say, through occasional wage rises. Or it may reflect the purchase of consumer durables such as TV sets, refrigerators, cars etc., which are bought only periodically, thus causing fluctuations in consumption demand, or it may be due to a combination of both of the above. These fluctuations may also reveal a sustained uncertainty about the future outcome of the economy and, consequently, of the household income. Most consumption theories suggest that current consumption reflects a memorized past income level, i.e. the longer the low-income phase, the more enduring the low propensity to consume out of current disposable income. Consumption may lag behind a possible rise in income, as the individual may fear that the improved income level is only temporary. The pattern of the consumption curve in Russia since the mid-1990s appears to prove this empirically: in 1997 the real consumption of good and services rose compared to the previous year. Obviously, individuals have gained confidence, as in 1997 the stabilization appeared convincing and inflation was reduced remarkably to roughly 11 percent from about 130 percent in 1995. Such fluctuations in consumption demand occurred again in 1998 and 1999. Until the ruble crash in August 1998, capital imports and lower inflation encouraged consumer demand, whereas in 1999 an output recovery helped consumption to rise from its record low after the August crisis the year before. From the demand-side viewpoint of economic policy, this implies that Russian consumers have had very unstable incomes over the last ten years and might respond more neutrally even to positive overall perspectives of the economy. Only if they are convinced that the recovery is sustained and that their income has improved permanently, will they raise consumption to a higher long-term level and therefore boost output growth.

Russia's infamous oligarchs took advantage of the redistribution of the national wealth which took place in the wake of privatization. By using insider information and misusing political links and personal connections, they managed to take over the most valuable industrial assets left over from the former USSR and became the "new Russian rich". Because consumption is linked not only to past and current labor income but also to the wealth available, an increase in wealth affects output. In the short run, when there is an increase in wealth, the portion of consumption from disposable income rises. So, have the few very rich contributed to a positive GDP performance or at least to a delayed output decline? Such wealth effects (actually effects of wealth redistribution) on consumption demand are, however, minimal, except for very large changes in, say, stock prices. This really did happen in Russia in 1997, but the stock exchange boom was followed by a severe crash and no net effect on the output can be

discerned. Moreover, in the long run the wealthy tend to consume less out of their disposable income, which diminishes any possible positive "spending spree" effect on GDP.

To sum up, the conclusion might be that the crisis diminished consumption demand, which is unable to recover, and thus output stays low, too. The redistribution of the national income has had no positive effect on overall consumption spending, i.e. the new rich's legendary "lavish spending" has not driven up the economy. Since the history of wide income fluctuations and uncertainty in Russia has been relatively long (roughly 10 years) it will – unless there is a fabulous GDP performance – take some time to restore the consumers' confidence and to accelerate output growth. The hesitant adjustment of consumption to any rise in incomes will cause output to adjust slowly to spending, too; and strong growth will take place only after the rise in incomes has been recognized as permanent.

A first conclusion to be derived for the policy response to the decline in consumer spending would be to try to raise the disposable wage income of the households. Governments can not raise wages (except in the civil service), but they can reduce taxation. In Russia this matter is complicated due to the fact that income tax is the main source of revenue for the regional budgets, whereas corporate tax is centralized within the Federal Government's budget. But while these are more technical difficulties, the main problem arises from the overall low labor income, resulting in only low household tax rates, as many workers do not receive their wages regularly. In better-off sectors such as services and foreign trade, tax evasion is commonplace, so that these sectors benefit from an "as if" tax reduction.

Much has been said about the poor record of the financial authorities, which have proved unable to collect the planned tax revenue, thus prompting a lasting fiscal crisis. But as outlined above, when taxes are reduced the multiplier rises and one ruble in additional demand affects output more strongly. Lower taxation – whether coming involuntarily or introduced by a government decision – serves to increase disposable incomes and thus to keep aggregate demand higher. Then, in a depression, the decline in output will be less severe than it would have been without tax cuts. In Russia, income taxes due decreased by one third between 1993 and 1999. Because of widespread wage arrears, income taxes collected contracted even more in real terms during the 1990s, by approximately 50 per cent. Since real wages halved, too, between 1993 and 1998 (Table 2), a net effect of a lower tax rate on the equilibrium output cannot be identified. The real wage cut occurred partly because enterprises do not pay wages regularly and partly due to the high inflation at the beginning and the end of the decade, which reduced real incomes such that many income receivers dropped out of the minimum tax brackets.

Table 2: Real wages and income tax due indices

Year	wage	income tax
1993	100.0	100.0
1994	91.3	89.8
1995	67.1	64.5

1996	75.8	63.7
1997	79.2	74.3
1998	66.5	66.3
1999	51.5	69.8

Sources: Russian Federation: Recent Economic Development, in: IMF Staff Country Report No. 99/100, Washington, D.C., September 1999 Table 21; Russian Economic Trends, op. cit., various issues, Tables 5.

2.4 Export demand

Unlike the other components of aggregate demand, Russia succeeded in maintaining net exports (the excess of exports over imports) over the depression period and continued to do so in 1999, when growth resumed. Increasing exports contribute to output growth and hence help the economy to overcome the crisis faster or to relieve the harshness of the depression. While domestic demand was sluggish, demand for Russian goods abroad kept exports on track. Therefore the export sector, especially oil and gas, kept the whole economy alive. The paramount importance of this sector for the Russian economy results from the export multiplier, which links exports with output and hence makes GDP changes dependent on changes in exports.[14] In Russia, exports constituted about 20 per cent of GDP in the 1990s. After the devaluation of the ruble, however, they surmounted a 40 per cent share in GDP in dollar terms in 1999 and are expected to stay high.[15] In this same year a strong GDP growth was reported, but it can hardly be attributed to changes in reported exports, because these were insignificant, rising from $74 to 74.5 billion in 1998 and 1999, respectively. Rather, export growth helped to keep GDP decline lower in the early 1990s, as exports expanded from $50 billion to $89 billion between 1992 and 1997. In the crisis year 1998, exports decreased sharply, which may have exacerbated the situation.

In the long run, however, the exports/GDP ratio may fall, since successive reforms may create a positive environment for investment and growth. Most countries show smaller exports/GDP ratios than Russia does at this moment, and if Russia adjusts, too, the relative importance of export demand within aggregate demand will decline. If one takes into account trade not only with goods but also with services, the picture changes toward a current account that is smaller than the trade balance. This is mainly because of the negative factor/income balance, i.e. Russia's net interest payments on foreign capital received. It is also caused by Russia's net service imports, especially travel abroad. While the current account/GDP ratio has always been positive but was relatively small before 1998, it increased sharply after the ruble

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14 According to the export base concept, Y = mX, where Y denotes the output and X the exports. The multiplier m is Y/X and hence > 1. Thus, a bigger change in exports causes a bigger output change. Source: Michael Bradfield: Regional Economics. McGraw-Hill, Toronto and Montreal, 1988, p. 38.

15 Sources: Roland Goetz: Russische Wirtschaft vor dem Aufschwung? Federal Institute for European and Russian Studies, Current Analysis No. 24, Cologne, 2000, p. 2; Russian Federation: Recent Economic Development, in: IMF Staff Country Report, op. cit., Table 26.

devaluation and reached 12.3 per cent in 1999, with a tendency to fall slowly in 2000 and after. From the viewpoint of a crisis-shaken economy, such high current account-to-GDP ratios indicate foregone opportunities to invest, since a portion of the domestic saving stays idle or is being lent to foreigners. To normalize the ratio between current account and output, income or imports – especially of capital goods – must rise. Given the clearly undervalued ruble right now, imports cannot catch up quickly, but foreign direct investment can, because at the current exchange rate Russian assets such as stocks are inexpensive in dollar terms. A privatization policy dedicated to opening the doors for investors might help to accelerate growth and thus to reduce net exports in favor of a higher domestic investment rate. Expanding domestic demand would increase imports, but once confidence in the reliability of the Russian reform policies is regained, possible negative current accounts can be financed by capital imports and thus by obtaining foreign savings to increase the investment rate further. A sustained growth needed to raise the standard of the economy and to support democracy can be achieved.

3. Demand-side policies

3.1 Monetary policy and aggregate demand

The monetary policy of the Central bank affects aggregate demand especially by encouraging investment, but also by influencing consumption spending. Furthermore, export demand can be controlled via the exchange rate setting. Demand-side policies therefore work on a wide basis and are important for restoring equilibrium in the case of recession or – as in Russia – of depression. A more aggressive money supply causes unanticipated price growth and contributes to a better trade-off between inflation and employment.[16] The more workers find employment, the larger the consumption effect, since a positive consumer sentiment causes people to purchase more goods. Commercial banks obtain easier refinance credit which they pass on to firms. These are encouraged by the lower interest rate to launch investment projects and, consequently, to put more employees on their payroll. Confident employees want more goods and services and boost consumption spending, and so forth.

In most cases, these policies may be successful in depressed economies, but sometimes business and individuals do not respond to such market-based interference, that is to say, households, firms and banks remain unaffected. Even advanced nations can become caught up in a liquidity trap – in recent times Japan is such an example, with a stubborn recession in spite of a real refinance rate of practically zero. Russia – an emerging market – was by now an example of failing demand-side policies too: especially in the early 1990s, the monetary policy of the Central Bank of Russia (CBR) was extremely loose. As remarked earlier, it provided money not only to the Federal Government but also to republics of the former Soviet Union (now the Commonwealth of Independent States) and even to the old Soviet-style industrial plants. The result was a high inflation rate – 2,500, 840 and 215 percent in 1992,

[16] The Phillip's curve states that when real wages decline firms are willing to hire more workers.

1993 and 1994 respectively, which discouraged both producers and consumers and failed to prevent the output decline.

The Central Bank was forced to do so especially for institutional reasons, namely, because of the lack of a smoothly working banking system. After 70 years without decentralized banking, a two-tier banking system was set up only in the late 1980s, and it soon mushroomed. The reorganization of the Soviet banking system led to the emergence of up to 3,000 new commercial banks. These were and remain, however, in general very weak, since even the largest private banks still have little equity capital and modest assets of only a few billion dollars. In terms of their assets, these banks are therefore 100 times and more smaller than comparable Western institutes. Initially, they were preoccupied with exchange rate transactions, as they purchased and sold dollars and other foreign exchange during a period of a precipitous fall of the Russian ruble. As of 1995, monetary policy became more tight, and each bank adapted in a different way, according to its market position and management interests. The state-owned Savings Bank, which attracts the overwhelming portion of household savings, responded by shifting its activities towards lending to the government in order to benefit from the high returns promised by government bonds. Although the Central Bank of Russia started to cut interest rates, while simultaneously fighting inflation more resolutely, it failed to encourage investment and consumption. The CBR's efforts were undermined by the government's fiscal policy on the one hand and by the government-owned Savings Bank on the other. As a result, household savings were channeled to the bond market, crowding out investment in spite of the attempts by monetary policy to create more stability and confidence for investment in industrial projects.

The myriad commercial banks notably stayed away from the bond market – in 1998 only about 14 percent of their credit portfolio was claims on the government – but they are mainly owned either by the same tycoons who own the private companies or by regional authorities, who arbitrarily dictate their credit policies. These banks do not contribute to converting national savings into investment. Whereas household savings constitute a minor portion of private savings in Russia, roughly about 4.5 percent of GDP, companies save approximately tree times more, that is about 12-13 percent of GDP.[17] In the 1990s, however, the banking system's claims on general government and the private sector surpassed the ruble and foreign exchange deposits by many percentage points of GDP. This claims overhang represents nonperforming loans, burdening the banking system (Table 3). The resulting credit crunch compelled the firms to finance their investment without drawing loans from the banks. The commercial banks failed to be a intermediary between saving and investment, and the Central Bank's attempts to expand credit is being torpedoed. One explanation for the discrepancy between the amounts of deposits and claims is the high interest rates, which expanded the debt of the firms, whereas shrinking sales and declining output impeded them from parking more savings in the banking system. Another explanation is the contradictory taxation system, forcing firms to hold cash and to convert every ruble they did not need for investment into

[17] Government of the Russian Federation, Russian Economic Trends, Monthly update, Southampton, various issues.

dollars to hedge against cash holding losses. The overall conclusion is that the business sector was preoccupied with fighting to survive instead of attempting to expand and modernize, so that the monetary policy of the Central Bank failed to encourage consumption demand.

Table 3: Credit and deposit performance of the banking system in the 1990s, ruble bn.

	1995	1996	1997	1998
GDP	1,540	1,245	2,521	2,696
Claims on General Government	62.6	150.7	191.5	259
Claims on the private sector	133.8	157.3	226	346
Total claims	*196.4*	*308*	*417.5*	*605*
Foreign exchange deposits	55.3	69.4	80.5	191
Household ruble deposits	70.6	118.4	148.2	150
Total deposits (savings)	*125.9*	*187.8*	*228.7*	*341*
Nonperforming loans	70.5	120.2	188.8	264
Nonperforming loans-to-GDP ratio	4.58	9.65	7.49	9.79

Source: Government of the Russian Federation, Russian Economic Trends, op. cit., Tables 1, 14.

3.2 Implications of the flawed banking system

Compared with other countries in transition, the money/GDP ratio in Russia is very low. This ratio indicates the degree of monetization of the economy and the ability of the banking system to expand the monetary base via the domestic credit supply. Since no single bank can lend more money than the bank's deposit amount, only the interaction between borrowers and all banks as a system can increase the availability of money. Thus, an ailing bank which cannot extend credit hurts other banks and firms, and so it halts the output recovery. Conversely, while the Central Bank mainly controls the monetary base, a healthy banking system enables the money/GDP ratio to widen. In the extreme case of a banking "system" consisting only of a central bank, the monetary base, roughly the currency in circulation, will be equal to the money stock, roughly the monetary base plus checking and various saving deposits. As deposits cannot be made and credits cannot be extended either, the currency available cannot be converted into quasi money. The money multiplier, which is the money stock-to-monetary base ratio, will be unity.

If there is a banking system, but customers prefer to hold less money in bank accounts and more money in cash in their mattresses, the multiplier will remain low and the money stock too. Conversely, the less the public tends to hold cash, the bigger the multiplier and the money stock. The public's propensity to park money in banks depends on the interest rate given on deposits, as higher real interest rates would increase the opportunity costs of currency holding. The deposit rate is influenced by the market interest rate, which is sensitive to the refinancing (discount) rate set by the Central bank to control credit expansion and therefore the money stock.

Table 4: Monetary aggregates in Russia and the West

Year	1995	1996	1997	1998	1999
GDP, rub. billion	1540	1245	2521	2696	4467
monetary base (M0), rub. billion	103.8	130.9	164.5	210.4	324.3
money stock (M2), rub. billion	220.8	288.3	374.1	448.3	704
M0/GDP	0.07	0.11	0.07	0.08	0.07
M2/GDP	0.14	0.23	0.15	0.17	0.16
money multiplier	2.1	2.2	2.3	2.1	2.2
Memo: OECD data					
M0/GDP	0.07				
M2/GDP	0.76				
money multiplier	9.8				

Source: Russian Economic Trends, op. cit. Tables 1, 13; IMF, World Economic Outlook, various issues, statistical appendices.

While the monetary base-to-GDP ratio (MO/GDP) is almost the same in Russia and the West, the money multiplier clearly differs (Table 4). In Russia there is a banking system with commercial banks unwilling to extend credit and individuals reluctant to entrust their money to banks. The reason is rather low, even negative, real deposit interest rates that discourage the demand for assets other than currency. A convincing correlation between deposit rates and monetization (the broad money M2-to-GDP ratio) can be identified (Diagram 5). The demand for deposits was elastic in 1996 and 1997, the real interest rates banks paid on deposits were positive. In the second half of 1998 and in 1999, deposit rates became negative in real terms and the elasticity diminished. If the elasticity of demand for deposits with respect to the interest rate is less than unity, this indicates that the public considers deposits to be "inferior goods" of fading importance.

Table 5: Deposit rates and deposit demand by the public

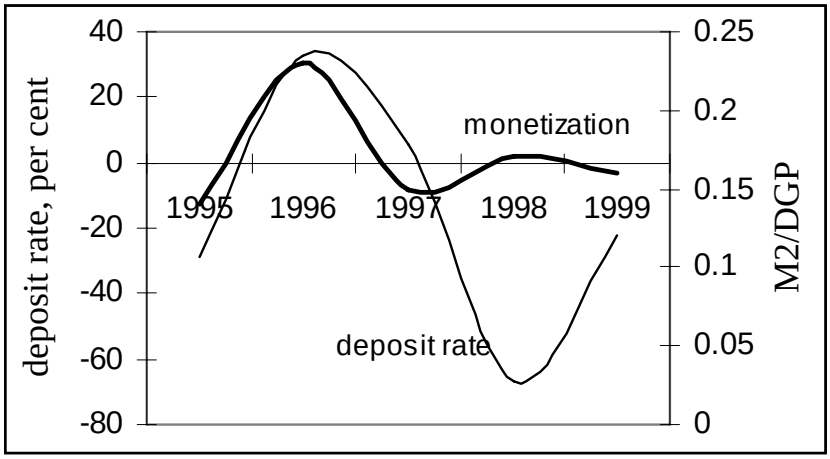
	real deposit rate, per cent	bank deposits growth rate, per cent	elasticity*
1995	-29		
1996	33	156.83	4.75
1997	5.8	45.16	7.79
1998	-67	-24.93	0.37
1999	-22.3	96.97	-4.35

* deposit demand elasticity with respect to interest rate. Source: Russian Economic Trends, op. cit., Tables 14, 15.

This is why monetization was at its peak in Russia in 1996, though far below the level in the advanced world (23 and 76 per cent of GDP, respectively). With real deposit rates decreasing, monetization also decreased to levels of about 16 per cent of the nominal GDP (Diagram 4), indicating a smaller money multiplier and less domestic credit. But why do the commercial banks offer low deposit rates and why do they not compete for the deposits of the public?

Commercial banks, like any other firm, work on a cost-benefit base, i.e. they try to lower their operating costs to enlarge the profit they earn. Consequently, a low, or negative, real interest rate on deposits fits well, as banks have to calculate the refinance cost resulting from the interest rate policy of the Central bank. The real discount rates of the CBR were very high in the mid-1990s and became temporarily negative only in the second half of 1998, before recovering again in 1999. As refinancing by CBR credits created high-cost liabilities of the banking system, it responded by trying to pass these costs on to its customers by charging high real interest rates on loans. Therefore credit became expensive for borrowers until 1998, and this provoked business to call for a loose central bank policy. Business people – whether red directors or small private entrepreneurs – have been permanently complaining about a "tight" money supply since the early 1990s, which they consider is causing a prolonged credit shortage. But since only the banking system creates quasi money, it does not make sense in a highly uncertain environment to urge the Central bank to print more money. This would just fuel inflation with little, if any, real effect on the economy.

Diagram 5: Monetization response to deposit rates



Source: Russian Economic Trends, various issues.

Thus, a well known tool for fighting recessions – pumping more cash into the real sector – turns out to be inefficient, because there is a defect in the link between the real and the monetary sector. While firms were suffering a liquidity crunch, banks were less and less prepared to give firms credit because of their fear of not being allowed to enforce their claims if a borrower repudiates on servicing his debt. Banks realized that, for political reasons or when elections are approaching, a company which is actually in default must be provided with even more credit to avoid bankruptcy and lay-offs. Although the courts in Russia are independent and a bankruptcy law has been in force since 1998, lenders usually lose lawsuits. This makes banks reluctant to compete for extending credit to the real economy. Money surrogates, credit crunch, and various arrears spread over the sectors. Easy money as a means of cure cannot contribute to more, but it can cause even less, stabilization. A vicious circle may look like this:

Banks extend credit – firms repudiate debt service – bank failures – low interest rates on deposits – currency/deposit ratio increases – money stock falls – credit crunch – depression – CBR expands money supply – firms repudiate again – credit crunch – CBR refinances firms[18] *– inflation – CBR raises interest rates – credit crunch – depression goes on.*

The next question is: why do firms default on servicing their liabilities? A company takes out a loan after careful analysis of its ability to repay it. Otherwise, it usually faces legal action by the lender, who may take over the collateral (assets) of that company or impose sanctions. In Russia, many firms produce with negative returns but make no effort to match costs and revenues. Either the management succeeds in persuading a bank to extend money by bribery and personal connections, or it simply relies on a permanent bail-out for political reasons. Since firms are not worried much about being closed or sold, they are less prepared to adapt to the market conditions and competition. They see credit as an easy way to buy supplies or

[18] The CBR ceased to extend credits to firms in 1994. In fall 1998 the CBR refinanced the commercial banks at low rates to prevent a bigger bank crisis.

pay wages and hardly bother about debt servicing. This cements the vicious circle referred to, in which a credit crunch caused by a paralyzed banking system plays a central role. The strong position of the borrower torpedoes the monetary policy of the CBR, causes a bank crisis and an overall payment standstill. More money cannot eliminate the liquidity trap as long as the leak – the bail-out mentality of business – is politically tolerated. Therefore, strengthening the Rule of Law is an important priority. It requires developing efficient institutions and effective legislative, executive and judicial systems. Legal reforms and the resulting enforcement of the Rule of Law are a prerequisite not only for establishing a climate conducive to investment, essential to achieving sustainable and equitable growth, but also for consolidating democracy and for building up the conviction that democracy and market economy are indivisible.[19]

4. Recent trends in the demand components

After the collapse of the pegged exchange rate in August 1998, output declined once again, but soon a recovery started, which finally culminated in 3.2 per cent GDP growth in 1999. This success was somewhat unexpected, since many analysts believed that the government would not be able to manage the crisis without another severe depression. Now, different approaches to explaining the result identify either favorable conditions or cyclical factors as contributing to growth. Usually, the former are linked to windfall gains from rising raw material prices and the increased competitiveness of import-competing sectors following the devaluation of the ruble. While the favorable conditions might be understood as transitory, the cyclical effects could be of lasting importance. In particular, the relatively successful stabilization of the economy in the fall of 1998 and in 1999 is considered a precondition for growing consumer confidence and better investor sentiment, paving the way for more spending and thus for growth. A closer look at the components of aggregate demand, however, casts doubt on whether the improved shape of the economy is really a durable one. As suggested earlier, when a recovery is under way, changes in investment spending and consumption reflect the confidence of business and households, who anticipate the turnaround. Trusting in expansion of demand, firms start to think about net investment to adjust the actual level of their capital stock to the desired level necessary to meet the additional demand. Individuals enlarge their spending because they feel confident that the income increase they are experiencing right now will continue in the future, too. Since increased investment spending triggers output activities across the whole manufacturing sector and beyond, whereas consumption spending constitutes the overwhelming part of GDP use, there is a stable link between this increase and output growth. Surprisingly, output reportedly grew in Russia, yet consumption and investment spending appear to have been sluggish since the August 1998 crisis (Diagram 6).

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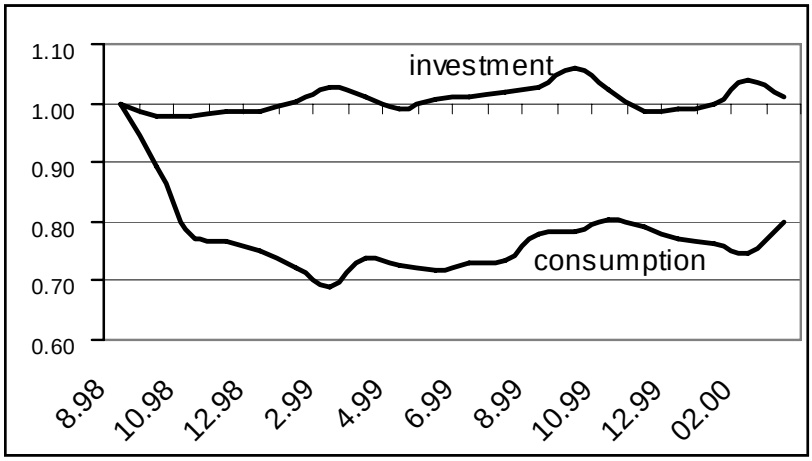
[19] The EU's relations with Russia – an overview, in: FT, 05/30/2000, www.ft.com

Diagram 6: Real consumption demand and fixed investment indices



Consumption seasonally adjusted. Source: Government of the Russian Federation, Russian Economic Trends, various issues, Table 1.

Specifically, consumption by the private households shrank in the aftermath of the crisis due to the inflation unleashed in the fall of 1998, and it rebounded only slightly in 1999. On balance, however, consumption has not yet returned to its 1997 level. The household sector consumption data fit the permanent income hypothesis, according to which individuals are initially reluctant to expand their consumption in spite of the obvious increase in their income. The official income index has been above the consumption index in real terms, although real income contracted temporarily in the fall of 1998. The consumption index also closely follows the real wage index,[20] which is well below the much broader income index. This indicates an uneven income distribution on the one hand and that consumers spend most of what they earn, since incomes remain low, on the other.

Investment spending typically reflects the reaction of business to the slump. In the last quarter of 1998, investment demand, for technical reasons, declined less than consumption – investment projects already launched could not be terminated immediately, but only with some time lag after the collapse of the ruble. Soon a recovery started, and pending decisions about whether or not to freeze current investment activities were made in favor of continuing them. The decline in investment was therefore unimportant. What is more striking, however, is the low rate at which investment spending rose in 1999. One explanation might be the reduction of inventories and thus low or negative inventory investment. Because firms can produce for a while out of stockpiles and reserves, they do not need to invest in more fixed capital immediately. Later, when running out of inventories and spares, they start to modernize and increase their equipment to meet higher demand by boosting output. Until now, firms in Russia have obviously been able to produce out of the current capital stock and have not – on balance – completed important investment projects. Another explanation might be the rental

[20] No data exist about the wages effectively paid; so the wages due were used to compute the index. Source: Russian Economic Trends, op. cit., Tables 5, 6.

cost of capital, which is linked to the interest rate level. Because a firm's opportunity to expand its capital stock depends not only on the level of output but also on the cost (price) of one more unit of capital, interest rates strongly affect this decision. Intuitively, when rates are high, firms refrain from borrowing to invest and vise versa.

Table 6: Monthly rates, per cent

month	inflation rate	nominal lending rate[a]	real lending rate
August 1998	4.9	1.38	-3.62
September 1998	38.4	1.37	-37.02
October 1998	6.3	1.38	-4.91
November 1998	8.2	1.37	-6.86
December 1998	17.6	1.36	-16.31
January 1999 to March 2000	4.8 (average)	1.35 (average)	-3.43 (average)

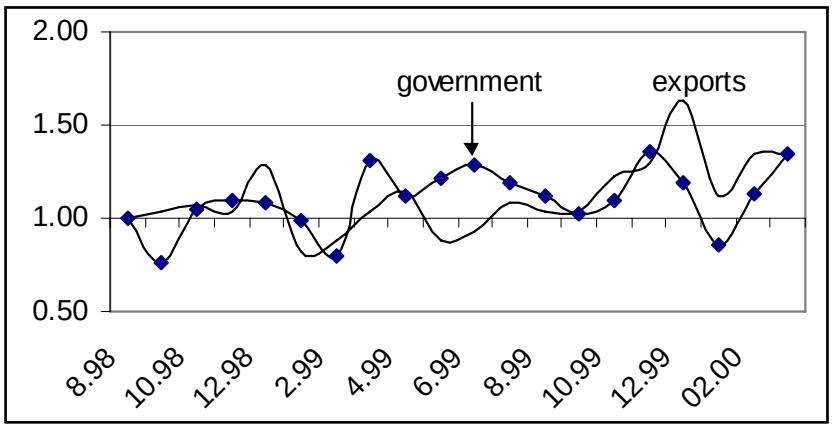
[a] Compound interest rate per year discounted. Source: Russian Economic Trends, op. cit., Tables 8, 15.

Astonishingly, lending rates in Russia never adjusted to the inflation rate and have always been pretty low, yielding a negative real lending rate (Table 6). After the price hikes in the fall of 1998, the monthly real lending rate at which banks extended credits was considerably negative, while the rates improved somewhat in 1999 and spring 2000. They still remained below zero, but it is a mystery why business did not rush to take advantage of these favorable conditions. It is conceivable that firms have been reluctant to invest because of disincentives such as high corporate taxation or lack of opportunities to deduct their outlays from their tax bill. But, as pointed out earlier, the corporate tax effect on the return on investment is neutral, whereas the Treasury accepts a tax credit to encourage investment. Therefore, it is hard to assess the outlook for investment spending in the short run. Since there are a lot of lingering obstacles on the micro level, it may remain sluggish with a negative output prospect. This would mean the asset stripping bias of business referred to earlier is going to prevail in the future too. It is also possible that willingness to invest may rebound in the near future, since there are no insurmountable macroeconomic impediments discernible, while business sentiment appears to be improving. This would revitalize the economy and while stabilizing aggregate demand also trigger sustained growth.

While consumption and investment can not yet strengthen the hypothesis that Russia is about to emerge from its long-lasting transitional depression, the recent behavior of government demand and exports support it. The improved budget data, especially, feed the conviction that the state is regaining a stronger position and is becoming able to control transformation more actively. The Treasury claims that tax collection is increasing and budget deficits diminishing in 1999. Government expenditures seem to have expanded at the same time (Diagram 7). At

least the data[21] available on Federal Government purchases and transfers support the hope that greater government demand is affecting aggregate demand and hence promoting GDP growth.

Diagram 7: Federal Government expenditures and effective export indices



Real terms. Effective exports include estimated unregistered trade. Source: Russian Economic Trends, op. cit., various issues, Tables 9, 11.

A glance at federal expenditures provides evidence that a link might exist between the recent growth and the improved performance of the budget. Just after the collapse of the crawling band[22] real expenditures shrank sharply, but recovered in the following months after inflation subsided. In 1999 Federal Government spending fluctuated around a clearly positive trend and increased on balance. As already suggested, assuming a high marginal propensity to consume out of disposable income and fairly low taxation, a large multiplier can be taken into account. The result is that even small spending increases have been sufficient to encourage some growth. Moreover, the good news from the federal budget makes it reasonable to assume that regional and local authorities have raised their spending, too. With government demand accounting for an increasing share in aggregate demand, the final effect may have been considerable.

Much has been said about the devaluation effect on output since the fall of 1998. Devaluation makes domestic items cheaper in terms of a foreign currency (which in turn appreciates) and promotes more exports, improved trade balance, increased competitiveness of the domestic sectors producing tradable goods, and thus GDP growth. Official data suggest, however, that exports have hardly risen; and that the trade balance is now better off only due to lower imports. A sharp depreciation followed by a decrease in imports may encourage domestic supply, since firms respond to the shift in demand from imported to domestic-manufactured goods – if it happens. But as analyzed earlier, domestic private demand was sluggish after the

[21] No monthly data are available on the regional budgets and extra-budgetary funds. Consequently, state demand is estimated on the basis of Federal government data, assuming a proportionate increase in spending at all levels.

[22] Until August 17, 1998 the ruble was pegged to the US dollar but allowed to depreciate by an announced rate.

devaluation and hardly contributed to the recovery at all. Instead, demand for imported goods in Russia was simply reduced, and no switch of the kind referred to occurred. With domestic private demand lower, the only positive effect of the devaluation might have been a better trade balance. In other words, the domestic manufacturing sectors have hardly benefited from devaluation up to now, or at least the resulting benefit appears insignificant.

Nonetheless, the economy has drawn some advantage from the new exchange rate policy. A closer examination of the behavior of the export sector suggests the conclusion that overall exports have increased (Diagram 7) and have thus supported revitalization of the GDP. Taking into account not only the officially reported export volume but also the "shadow" exports, overall export demand has encouraged more output growth. Otherwise it would be hard to explain the respectable 3.2 percent growth in 1999 merely by the increase in just one component of aggregate demand, notably government spending. If exports are added, the picture rounds up, since these constitute a large portion of the current GDP. Amazingly, a strong increase in exports is more clearly seen as of the second half of 1999, whereas in the months before they oscillated around the old trend. This can be partly explained by seasonal factors (the hard Russian winter is a less suitable period for pumping oil or natural gas), so exports declined in the last quarter of 1998 and recovered in the following spring. Yet it is a riddle why exports failed to flourish in the summer of 1999. On the contrary, they caught up somewhat later, when a real appreciation of the ruble actually may have reduced the competitiveness of Russian exports.[23] As a trend, exports nevertheless rose between fall 1998 and spring 2000, and have supported the recovery. Especially when a strong multiplier is taken into account, the large share of export demand in aggregate demand suggests a strong impact on output growth.

5. Implications of the demand trends for future growth

So far, the analysis has delivered a mixed picture about whether the nascent recovery might be considered a sustained or transitory one. Sustained growth refers to a cyclical improvement, whereas the transitory effects might expire in the short term and thus cause another economic slump. From the demand-side viewpoint, the most relevant cyclical indicators are investment and consumption spending, since these are endogenous and reflect the expectations of business and the households.

The analysis of investment demand failed to shed light on the question of whether firms are percieving a better outlook for the economy and hence intend to raise their capital stock on hand. A successful macroeconomic stabilization assumed, low interest rates and reliable exchange rate policies should, intuitively, encourage investment decisions. Since these have obviously been postponed until now, the reason may lie on the micro level, where property rights uncertainties and arbitrary local administration strengthen the tendency towards rent seeking rather than profit seeking. The rent seeking hypothesis can be refuted, however, if it

[23] The Central Bank of Russia sticks to a managed float of the ruble, allowing nominal depreciation that is lower than the inflation rate and thus causing a creeping real appreciation.

turns out that business has already launched investment projects which may take effect in the coming months. This idea appears to be corroborated by data on bank loans, as 1999 and the spring of 2000 have seen an increase in banking sector net claims on the private business sector in real terms. Fortunately, this increase cannot be attributed mainly to nonperforming old loans, since overdue payments have not risen since the fall of 1998. Also, firms have hardly been using loans to settle their arrears, for the amount in arrears has been kept more or less constant in nominal terms.[24] In real terms arrears have halved in the meantime. This implies that firms have been settling their arrears by devaluing them rather than by cash payment. Unless managers have siphoned borrowed money abroad, they might have used bank credit for investment, thus growing investment spending on new equipment might be under way. This will be a clear sign that the recovery in output is a lasting one and will confirm the current trend of the GDP outcome.

Private consumption has not recovered and hence could not play any positive role in supporting output growth. This is not surprising in the light of the hypothesis that current consumption decisions by individuals reflect their past experience. Since income and thus consumption have decreased in the past few years, even a good economic outlook leaves the Russians cautious, prompting for a while a consumption trend that lags behind the output trend. If improving consumer sentiment does not collapse soon, consumer spending is expected to expand, which may put growth on a sustained path.

Under such circumstances, the behavior of the other two demand components, notably government spending and export demand, take on crucial importance. Moreover, both are strongly integrated, since government expenditures, which rose between fall 1998 and spring 2000, are at present heavily dependent on the export outcome. The government took advantage of the undervalued ruble and rising prices for crude oil and other export items in 1999. For instance, tariffs on exports of crude oil account for about 8% of the federal budget revenue and are denominated in euros, thus enabling a larger ruble equivalent of the tariff revenues, attributed to the higher world market prices in dollar terms. Even if the direct effect of higher oil prices on budget revenues may not have been large (since oil companies usually pay taxes according to individual agreements negotiated with the Treasury, which do not immediately take into account higher oil prices), a positive effect can be discerned from the increased profitability of the oil companies' suppliers and a greater proportion of cash settlements from which the budget also benefits.

The increase in federal budget revenues is therefore being driven right now mainly by exogenous factors: the increase in export sector competitiveness thanks to devaluation, and the effect of higher export prices.[25] If these factors should fade away, expenditures will, ceteribus paribus, have to contract because of the strong budget constraint resulting from the huge overall (domestic and external) government debt. They can therefore only go hand in hand with improved revenues, especially from a larger tax base and better tax collection. A deterioration

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[24] Data sources: Russian economic trends, op. cit., Tables 7 and 14.

[25] Knut Eggenberger, Has Russia Turned The Corner? in: Russian Economic Trends, op. cit., May 1999, p. 7.

of the terms of trade accompanied by a stronger ruble may undermine the prospects for growth.

The money supply outcome also indicates prospects for a recovery in output, since an expanding money supply in real terms usually reflects depositors' confidence, and therefore more savings are available for passing on to investors and consumers via the banking system. Between fall 1998 and spring 2000 the currency/deposit ratio first worsened, but later improved. Typically, when depositors get hit by an exchange rate collapse or inflation, they withdraw deposits from the banks. This way they raise the currency/deposit ratio, while simultaneously reducing the money stock. During the August-October 1998 period, the currency/deposit ratio jumped from 63 to 79 per cent, but normalized somewhat in 1999 and continued to decline in spring 2000, reaching 50 per cent at this moment. The money multiplier, for its part, increased slightly, too.[26] These improvements appear, however, insufficient to derive any serious conclusions, since for example the monetization of the economy did not augment, indeed, it has even decreased meanwhile. The slow and deficient recovery of the currency/deposit ratio either reflects an ongoing low savings rate in Russia, where households consume almost their whole disposable income. Or it is linked to a continuing skepticism about whether the banking system is a reliable place to entrust savings to, considering the depositors' poor experience during the 1990s, let alone the fact that deposit rates are negative in real terms. While ruble deposits shrank sharply and have not yet caught up with their pre-crisis level, dollar-denominated deposits have rebounded more or less but still remain below their level in summer 1998. But larger dollar-denominated deposits might result from the currency control policies imposed by the authorities on export/import transactions in the post-August 1998 period. Even if this is not so, more foreign exchange savings are evidence of uncertainty among households and indicate ongoing skepticism concerning the short-term prospects of the economy. This in turn is going to perpetuate the vicious circle of pessimistic expectations, low consumption spending and poor output growth.

Finally, mandatory reserve rates on all deposits were increased in 1999, which per definition lowers the money multiplier and thus cuts the money supply. The reason is that the excess reserves of the banking system have continued to increase, since banks only reluctantly transform reserves into "useful" assets such as loans. Although they would prefer to buy securities, the tiny Russian securities market puts tough limits on this. To prevent banks from using their reserves to purchase foreign exchange and thus from expanding the currency, the Central Bank raised reserve requirements. Higher excess reserves accompanied by higher mandatory reserves mean less money available for lending. A currently smaller multiplier limits domestic credit expansion and at the same time opportunities to invest or to draw consumption credit at this time.

It is therefore hard to assess whether the recent grow may be considered as a sustained one or not. Important components of aggregate demand, which usually drive output revitalization, have been sluggish in the aftermath of the August 1998 crisis. Surprisingly, successful stabiliza-

[26] From a 2.27 bottom to a 3.0 peak in October 1998 and February 2000, respectively.

tion took place in late 1998 and, despite sluggish investment spending and consumption, a remarkable recovery followed in 1999. The reason is that favorable circumstances have contributed to this recovery. Output has recovered thanks to a temporary improvement in the competitiveness of the export sector and the expansion of government purchases and transfers. Under such circumstances, the cyclical improvements are of crucial importance. Otherwise, the gains from massive currency depreciation and higher raw material prices should be considered windfall gains, which tend to abate – either because the exchange rate policy pursued by the Central bank is causing a gradual real appreciation or because oil prices are going to decline in the future. For instance, about 40 per cent of the Federal budget revenue at this time comes from foreign trade operations.[27] A gradual ruble appreciation in real terms will make Russia's oil and gas exports less competitive. Contracting exports will harm the improved budget revenues, hence the larger expenditures will turn out to have been only transitory. Furthermore, a stronger ruble will cause export demand to decline and hence reduce aggregate demand. As a result, unless the other demand components rebound, GDP growth is likely to collapse.

[27] Russian Economic Trends, op. cit., p. 8.

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Russia's economic transition – the outcome and the prospects

Sustained growth possible, but with caveats

Bericht des BIOst Nr. 16/2000

Summary

Introductory Observations

The transitional depression in Russia is proving to be worse than the Great Depression in the US, because severe demand-side shocks badly affected the components of aggregate demand in the 1990s. Yet recent data report a strong recovery, which is a confusing puzzle, since different hypotheses may be put forward to explain it. One of these considers the current output growth to be transitory, caused by a convenient constellation of favorable macroeconomic conditions. Another explanation pattern rests on the conviction that Russian stabilization happens to be durable, being the result of improved fundamentals. Consequently, a growing confidence in the ability of the authorities to handle the economy is feeding optimism among investors and consumers, and driving up output. Admittedly, the task of proving the one or the other hypothesis is not straightforward, since facts may simultaneously support and refute either.

Findings

1. The contraction of investment demand, which accounts strongly for the business cycle, provides an idea of why the depression has been so deep. The transition reform really got started in 1992, but the fixed investment rate began to fall and seems to have bottomed out only in 1999. Investment demand usually responds to interest rates, and the monetary authorities are expected to make investment attractive. Sometimes, however, depending on the sensitiveness of investment demand to interest rates, low rates fail to encourage investors. In the early 1990s, especially, real interest rates in Russia were clearly below zero – just in the phase of the most precipitous decline in investment spending. Under such circumstances the opportunities open to monetary policy – as the Russian experience proves – are limited.
2. But fiscal policies failed too: for several years deficit spending was rampant, but investors compared the expected discounted returns from alternative investment and avoided putting money into factories. Instead, banks, investment funds and private persons rushed to take advantage of the high interest rates offered by government bonds. Surprisingly, it seems that the widely criticized corporate tax rate tends to discourage investment

decisions to a lesser extent; what is a cause of much more complaint in Russia is the arbitrary taxation and the uncertain tax legislation.

3. Because of the output depression and wide spread tax evasion, massive cuts in government spending led to a reduced-size government. The result was a shrinking aggregate demand and output. For instance, one ruble less in government purchases caused, ceteris paribus, a decline of up to three rubles in the nominal output. On the other hand, the transfer payments made by the authorities have partly outweighed the decline in expenditure. In real terms, transfer payments increased by almost 45 per cent between 1992 and 1998. Transfers caused aggregate demand to respond less strongly to the cuts in government purchases. The combined effect of decreased purchases and increased transfers may have led to an overall fall in the real GDP by roughly 39 percent within 8 years.

4. Consumption spending declined in real terms less than output. However, because it accounts for most of the aggregate demand, when it decreases it causes output to drop, too. The redistribution of the national income in favor of the "new rich" has had no positive effect on overall consumption spending, i.e. the new rich's legendary "lavish spending" has not driven up the economy. Since the history of wide income fluctuations and considerable uncertainty in Russia has been long (roughly 10 years) it will – unless there is a fabulous output performance – take some time to restore the consumers' confidence and to accelerate output growth. The hesitant adjustment of consumption to any rise in incomes will cause output to adjust slowly to spending too; and strong growth will take place only after the rise in incomes has been recognized as permanent.

5. Unlike the other components of aggregate demand, Russia's exports helped the economy to overcome the crisis faster, or alleviated the depression. The paramount importance of this sector for the Russian economy results from a fairly large export multiplier at this time. Simultaneously, data display a pretty high current account/GDP ratio and thus forgone opportunities to invest, since a portion of the domestic saving is being lent to foreigners. A privatization policy dedicated to more foreign direct investment might help to accelerate growth and to reduce net exports in favor of a higher domestic investment rate.

6. The demand-side policies of the Central Bank caused a low broad money-to-GDP ratio, which indicates a restricted ability of the banking system to expand the monetary base via domestic credit supply. Individuals seem reluctant to entrust their money to banks because of low, or negative, real deposit rates. The elasticity of demand for deposits with respect to the interest rate is now less than unity, i.e. the public considers deposits as "inferior goods" of fading importance. A low currency/deposit ratio curbs the money stock and discourages investment. Banks offer low deposit rates in response to high refinance cost provoked by the interest rate policy of the Central bank. Until 1998 they passed these costs on to customers, requiring high lending rates, which suffocated the economy.

7. Somewhat unexpectedly, the economy started to grow in 1999. This is due either to exogenous factors (windfall gains from rising raw material prices and the devaluation of

the ruble), or to cyclical reasons. While the exogenous factors might be understood as transitory, the cyclical effects could be of lasting importance. A closer look at the components of aggregate demand, however, casts doubt as to whether the improved shape of the economy is really durable. An analysis of investment demand has failed to prove that firms are considering prospects better and are intending to raise their capital stock on hand. Private consumption has not recovered, either, and hence cannot play any positive role in supporting output growth.

8. Under such circumstances patterns of government spending and export demand become crucial. They have both increased and seem to be keeping aggregate demand on track. Were the transitory exogenous factors to fade away, government expenditures would, ceteribus paribus, have to contract because of the strong budget constraint. This may, along with a possible worsening of the terms of trade and a stronger ruble, undermine growth prospects.

9. Nor is the money supply outcome a definite indication of oncoming sustained growth. An expanding money supply usually reflects depositors' confidence, resulting in more savings available for lending to investors and consumers by the banking system. The slow and deficient recovery of the currency/deposit ratio reflects an ongoing low household saving rate in Russia. Also, skepticism about the banking system continues, considering depositors' poor experience during the 1990s, let alone the fact that deposit rates are negative in real terms. Moreover, the Central Bank has injected money into the banking system which latter cannot lend out. Therefore, the additional liquidity (accompanied by higher mandatory reserves) has not helped to overcome the credit crunch. At this time, a small multiplier is limiting domestic credit expansion and simultaneously the output prospects. While in the past a looser monetary policy caused inflation, right now it has failed to accelerate the economy.

10. Therefore, it is hard to assess whether the recent growth may be sustainable or not. Uncertain exogenous factors require the cyclical factors – especially investor and consumer confidence – to rebound. Otherwise, the current output revitalization is likely to collapse.